# Quadrant II - Notes

**Paper Code: ECC 106**

**Module Name: Industrial Policy of 1991**

**Module No: 07**

## Introduction

After independence, India adopted the socialist pattern of economic growth. The Mahalanobis model was taken as the model of economic growth through the industrial policy resolution of 1956. However, by 1991 this model was proving unsustainable, and the country was facing a severe economic crisis. This was triggered by the fall of the Soviet Union and India was facing a serious Balance of Payment crisis. India was left with Forex reserves to cover just around 15 days of imports. During these circumstances, the new Industrial policy of 1991 was adopted with three main pillars of liberalisation, privatisation, and globalisation.

The new industrial policy 1991 aimed to improve industrial growth as the previous licensing policies and regulations were responsible for lower growth rate and balance of payment crisis.

## Objectives of Industrial Policy of 1991

- The new industrial policy resolution 1991 aimed at liberalizing the regulations and license controls of the industrial sector to improve economic growth rate.
- It aimed to increase the support to Micro Small and Medium Enterprises (MSMEs).
- To reduce the losses of public sector enterprises and make them profitable.
- To ensure Rapid industrial development by increasing the competitiveness of industries and to ensure inclusive economic development.
- To provide incentives for setting industries in the backward areas.
- To reduce the inflation rate and remove the imbalances in payment.

- It also aimed to build sufficient Foreign Exchange Reserves.
- The policy aimed to permit the international flow of goods services capital technology and human resources with fewer restrictions.
- It wanted to increase the share of private sector in the economy, and hence the number of reserved industries were reduced.

## Major Outcomes of Industrial policy of 1991

### Industrial De-licensing policy

- The licensing policy which was the part of new industrial policy 1991 who was aimed to end red tapism and licence Raj in the industrial sector. Previously, the private sector industries had to secure licenses to start an industry. This had led to red tapism and delays in starting new industries or expanding the old ones. The new industrial policy of 1991 reduced the industrial licensing to around 18 sectors, which was further reduced to 5 over a period of time.

### Dereservation of the industrial sector

- After the adoption of Mahalanobis model in 1956, the responsibility for industrial growth was on the public sector industries. However, the public sector Industries became inefficient and the government faced the burden of perpetual losses.
- Under the industrial deregulation, most of the industrial sectors were now opened for the participation of private sector. Only three sectors- atomic energy, mining, and railways continue to be reserved for the public sector. The new industrial policy increased private sector participation and all other sectors were opened for them.

### Abolition of phased manufacturing programs

The government abolished the phased manufacturing programs and devalued currency to increase the foreign direct investment. The government liberalised the local content requirement for the indigenous industries.

**Abolition of MRTP act**

- The new industrial policy 1991 abolished the Monopoly and restrictive trade practice act (MRTP) to remove the threshold limits of assets of the MRTP companies. Earlier, according to the MRTP Act 1969, companies having assets worth Rs 100 crore or more were subjected to many restrictions.
- After the new industrial policy 1991, the firms do not have to obtain prior approval of the government for taking decisions related to investment. It has allowed the emergence of strong and competitive domestic private sector companies along with many foreign companies.
- Further, the public sector enterprises were now provided a greater degree of Management autonomy through the system of the Memorandum of understanding (MOU).

**Foreign investment and Technology**

- The new industrial policy 1991 increased the flow of foreign direct investment (FDI) in India as government liberalised its FDI policy. Also, FDI was to bring better technology, modernize industries, increase exports by improving the quality of goods and services as per the international standards.
- The Government adopted the two routes for FDI approval, the automatic approval by Reserve Bank, and government approval through foreign investment promotion board (FIPB). It categorised the industrial classification based on approval up to 50/51/74/100% FDI.
- Sectors like electricity generation and transmission, roads, highways, vehicular bridges, ports and harbours etc were permitted 100% FDI under the automatic route. However, in sectors like agriculture, real estate etc FDI was not allowed.
- The foreign companies were now allowed to leverage domestic Debt from the domestic Financial Institutions. The external commercial borrowings and Debt servicing norms were also liberalised.

### Government support to Small scale industries

- The new industrial policy 1991 provided greater Government support to the small scale industries for their rapid growth and improvement in economic efficiency through technology upgradation.
- The government allowed equity participation by the large industries in the small scale sector up to 24% of the total shareholding. This was to provide the small scale industries access to capital market and to promote their upgradation and modernization.
- The government policy also encouraged the production of parts and components and other products used by the public sector industries in the small scale sector. Also, some industrial sectors were reserved for the tiny and small scale industries.

### Liberalisation of industrial location policy

- The new industrial policy 1991 liberalised the industrial location policy and it provided that the locations other than cities having the population over 1 million were not required to obtain industrial approvals except for industries subjected to compulsory licensing.
- In the cities having a population more than 1 million, the industries other than the non-polluting nature were to be located 25 km outside from the Periphery of the city. The non-polluting Industries such as electronics, printing, computer software etc where exempted from this restriction.

### Removal of mandatory convertibility clause

- A large part of investments in the industrial sector in India are financed by the banks and Financial institutions. Earlier, the banks and Financial Institutions had followed a practice of mandatory convertibility clause through which a part of their loans could be converted into equity. The new industrial policy 1991, removed this mandatory convertible clause and hence forth the Financial Institutions do not impose this mandatory convertible clause.

**Free determination of interest rate by commercial banks**

- The new industrial policy 1991 liberalised the interest rate charged by the banks and Financial Institutions. Now the RBI did not determine the rate of interest, and the, commercial banks were independent to determine their rate of interest.

**National Renewable fund to provide social security to workers**

- The Government established the National renewable fund (NRF) to provide a social safety net to retrenched labourers and provide relief to workers who were rendered unemployed due to technological changes.
- NRF was set established in 1992 and two schemes, the voluntary retirement scheme (VRS) and the retraining scheme for rationalised workers in organised sector were brought under it. The fund was later abolished in the year 2000.

## Positive outcomes of the new industrial policy 1991

- The policy liberalised the economy by removing the bureaucratic red tapism and other impediments to the industrial growth. It ended the policy of license, permit and quota Raj.
- The role of public sector industries in the economy was reduced which reduced the burden on the government. The government used the policy of disinvestment in the public sector enterprises facing financial losses.
- The measures of liberalisation increased competition in the industrial sector which improved their efficiency, and lowered the prices of many goods and services which ultimately benefited the customers. The removal of MRTP companies brought increased foreign investment in the private sector industries.
- The special initiatives such as the Special Economic Zones (SEZ), Export Processing Zones (EPZ), Export Oriented Units (EOU) etc taken under the new economic policy 1991 increased the exports from India. It also helped to increased the Foreign Exchange Reserves of India.

## Evaluation of the new industrial policy 1991

- The overall results of the new industrial policy 1991 have been dramatic for the economic growth of India. The steps taken under this policy such as the abolition of industrial licensing, abolition of monopoly law, relaxations on the foreign investment, reduction in the corporate and personal taxes, removal of price controls etc were very important steps taken to boost the industrial and economic growth.

- The monopolistic role of the public sector has now been confined mainly to strategic sectors such as atomic energy etc. However, the benefits of new industrial policy has not benefited all the sections of society equally and therefore more steps need to be taken to ensure inclusive economic development.